4

itizen's Course in

EEDOM vs. COMMUNISM:

e Economics of Survival

ETS WHAT

1 The Communist Challenge
2 Consumer Control or Controlled Consumers
3 Profit Motive or Master Plan
4 Who Gets What
5 The Role of Government
6 The Big Picture
7 Meeting the Economic Challenge
8 What You Can Do About Communism

CHAMBER OF COMMERCE OF THE UNITED STATES
Washington, D.C.

"There were those who wrongly understood the right of work to mean the right to choose their own places of employment in disregard of the interests and needs of the State."

—Politburo member Shcherbakov—Speech on 17th Anniversary of Lenin's Death.

Who Gets What

CONTENTS

The Carrot or the Stick 2

How the Rewards of Production Are Distributed in the Soviet Union 4

Incentives and Rewards in Soviet Agriculture 8

How Rewards of Production Are Distributed in the United States 13

Government Redistributes Income in the United States 24

Material for
A Citizen's Course in
FREEDOM vs. COMMUNISM:
The Economics of Survival

Discussion Leader's Manual .... $8.00 (each)
(*One* manual is needed for *each* course *group*)

Sets of Problems & Exercises .... $4.00 per set
(*One* set is needed for *each group*. Set includes case problems and other workshop material for 20 participants)

Sets of Eight Pamphlets (boxed)
(*One* set of pamphlets is needed for *each* course *participant*)

1-9 sets	$4.00 per set
10-99 sets	3.50 per set
100 or more	3.00 per set

Order from:
PUBLIC AFFAIRS DEPARTMENT
Chamber of Commerce of the United States
1615 H Street, N.W.
Washington 6, D. C.

1st Printing, November 1961
2nd Printing, February 1962

Library of Congress Catalog Card Number: 61-18198

Who Gets What

IN THE PRECEDING PAMPHLET *(Profit Motive or Master Plan)*, efficient production and higher productivity were described as keys to improve human well being.

The pamphlet emphasized that in neither the controlled economy of the Russians nor the market economy of the United States can more material goods be distributed than are produced, and that many things, such as improved skills, more efficient plants, and newer equipment help increase productivity.

After increased production is achieved, however, other questions arise: How shall the rewards from this production be distributed among the people? Who—or what—shall determine who will get the fruits of production? What share of increased productivity will go to labor in the form of higher wages? What share will go to owners of business in the form of profits? What share, to lenders? To consumers?

The distribution of any nation's income is admittedly a difficult and complicated subject. Moreover, it is a subject which arouses strong emotions—in every country in the world.

Why Do Men Work?

KARL MARX LIKED TO refer to man as a "producing animal." But most people—whether in the United States, or Russia, or China, or elsewhere—don't work merely for the sake of working. Why do men work?

Asking why men work may appear to be a superficial question. Yet, economists have spent a lot of time studying "incentives and rewards". An understanding of the motives and drives that make people work—and the rewards they receive for working—is useful in understanding the differences between economic systems.

Is there any difference between the reasons men work in Russia and the reasons they work in the United States? What rewards do they receive for working in each nation?

The Carrot or the Stick?

IN BOTH CHINA AND RUSSIA extensive education and propaganda campaigns are used to persuade workers that they must work where they are needed, and that they must work hard "to surpass the United States." A controlled economy cannot operate with the use of propaganda alone—it must also employ force and coercion.

Under Stalin, a single day's absence from work might bring as much as six month's punishment in a forced labor camp. Stalin introduced, too, a system of "labor books" under which men were "frozen" in particular jobs. Each worker was issued a labor book which he surrendered to the plant manager when he took a job. Since he could not get another job without this labor book, it meant, in fact, that he could not change jobs unless the Communist-directed manager of the plant decided to return his book to him.

The number of workers who passed through Stalin's labor camps in 25 terrible years cannot be estimated accurately. It has been placed at anywhere from 10 to 25 million. Some of these people were considered political enemies, but there is abundant evidence that "slave labor" was used to cut timber, mine gold and coal, and construct railroads in forbidding areas of Siberia.

The same pattern, perhaps on an even more intensified scale, is being followed in China. Millions of Chinese were killed during the early years of Mao Tse-tung's government. More recently, China has been subjecting uncooperative workers to long months of "brainwashing" to remould them into more willing workers for the State.

Since Stalin's death and his "down-grading" by Premier Khrushchev some of the work rules have been relaxed. The number of executions and long sentences to hard labor have diminished. But few dispute the fact that the memory of past "purges" helps obtain cooperation from the Russian people.

Moreover, some experts believe that the new work rules do not give the workers as much freedom as they appear to do.

Paul Barton, the well-known student of Soviet labor conditions, has commented on the decree of 1956 which was supposed to lift the ban against changing employment and the compulsory shifting of workers from plant to plant.

> The freedom to choose and change employment has not, in fact, been restored at all. A worker who leaves his job against the wish of the director runs the risk of being entangled in a whole network of constraint and administrative chicanery, which may finally prevent him from being hired where he wished. The police, from whom, on the presentation of his internal passport, he must obtain permission before every change of residence, can forbid him to leave his home. Even if he manages to find work where he lives, he may be threatened by "organized recruitment," a process by which the authorities obtain labor for sweating industries.
>
> Besides this, he will lose, for six months, the right to sick pay and, permanently, his seniority on which depends the extent of various social benefits . . .
>
> To be sure, these modifications make the workers' lives a little easier. But at the same time, that is clearly not its aim. This lies in enabling the managers and the authorities to apply restrictions on the wage earners in a more varied, subtle and hence more efficient manner; drastic measures are not always the most effective.
>
> The same applies to all the other changes which have occurred in recent years. There is no question at all of ending the exploitation and servitude imposed on the workers by Stalin; Khrushchev simply wants to eliminate the disorganizing effects which a rigid policy has on industrial relations and even on production. After all, Stalin himself did as much during the period of spring 1934 to summer 1938; it did not prevent him from crushing the workers again, and more than ever, from December 1938 onward, when he judged that industrial relations were in sufficiently good order.[1]

Russians Seek Higher Pay

The fact that the Government must always wield some form of a threatening "stick" in the operation of a controlled economy is of utmost importance in any comparison of the two countries.

If five million tons of coal are to be mined in a remote,

forbidding area according to national plans, adequate machinery and a transportation network that will be used to transport the coal where it is needed must also be planned. Most important, the supply of labor must be controlled. The planners must make sure that enough men are available to mine the coal and to operate the transportation network. If the workers are unwilling to go to Siberia, they must be compelled to go, whereas in a free and open society the employer must bid high enough to attract free workers.

Even in Russia, though, people will not work well solely on the basis of force and compulsion. The Russian leaders make many appeals to pride, patriotism, and the desire for prestige. They also have been compelled to offer many more rewards for performance than Communist doctrine envisioned.

Today, although the average Russian may recognize the threat of discipline, he probably works primarily for the same reason you do—to earn money with which he can buy the things that will give him and his family a higher level of living.

A few years ago, when many Russians were interviewed by members of the Harvard project on the Soviet Social System, it was discovered that the *level of pay* was the strongest factor in determining the attractiveness of a job. In other words, the most desirable jobs were those that paid the most—even though the jobs had the most "political" dangers.

Since both the Russian worker and the American worker want the same things—higher pay and a better scale of living—let's examine how the two systems meet their wants.

How the Rewards of Production are Distributed in the Soviet Union

In Russia, the State sets the wages that workers receive. It sets the hours they work and the conditions under which they work.

Since the Russian Government does not publish statistics on average money earnings, the student must estimate them. But

everyone agrees, of course, that the wage scale is far below that in the United States. An economist with the Department of Labor estimated in 1960 that the average Russian worker living in a city received about 800 rubles* or about $80 a month . . .[2]

Lenin, the founder of modern Communism in Russia, was fond of quoting the Communistic slogan, "from each according to his ability, to each according to his need."

Communists may still talk of distributing rewards "according to need" in some far-off future day, but in practice they have found such a system absolutely unworkable. As a result, they have turned increasingly to the "capitalistic" system of relating rewards to production.

Stalin turned his back on Communistic theory by emphasizing that "wages must be paid according to the work performed, and not according to needs."

Khrushchev has followed him with speeches on "the very important duty of party organizations and administrative organs to wage a struggle against manifestations of wage leveling . . . the worker with higher qualifications, people who show the best example in their work, must receive greater material benefits."

In accord with this philosophy, wide variations in wages and salaries exist. A factory or a plant manager might receive the equivalent of $300 to $1,000 a month—*not counting many other advantages, such as the use of a house or car.* The unskilled worker might receive anywhere from $27 to $50 a month.

The relationship of wage scales to production is even more clearly evidenced in the spread in the basic hourly wage rates of production workers within the same industry, and by the prevalence of the "piecework" system.

Wage Differentials

A STUDY by the Bureau of Labor Statistics showed, for ex-

*On January 1, 1961 the ruble was revalued, at the rate of 10 old rubles for one new "heavy" ruble. In theory, all prices, wages and savings were cut to one-tenth of what they were in terms of old rubles. The change does not materially affect the real living wages of the workers, or their wages as expressed in terms of U. S. dollars.

ample, that there was a much wider spread in the basic hourly wages of production workers in the Soviet steel and construction industries in 1951 than in the same type of industries in the United States. The highest basic wage rate for skilled workers in each of these industries, whose wage structures were typical of most Soviet industries, was more than 3.6 times that of the lowest paid workers. In the United States, it was found that the ratio was approximately 2.2 in each industry.

Since that time, the Soviet Government has adopted a policy of decreasing the spread in basic wage rates, but widespread wage differentials are still prevalent in the Soviet wage system.

Piecework Compensation

SECOND EVIDENCE OF THE emphasis placed on relating pay directly to production in the Soviet Union is the widespread use of the "piecework system."

Joseph E. Evans in his book *Through Soviet Windows* puts it this way:

> Ivan finds his exact pay fluctuating according to how well he fulfills his norm or work quota. Usually a norm is based directly on the volume of piecework production. In a Moscow bicycle shop Zinaida Markolova's norm is to put spokes in 90 wheels a day, for which she would get 700 rubles a month. But she regularly assembles between 100 and 150 wheels—looks plenty busy doing it, too—and so makes between 800 and 850 rubles a month.[3]

The setting of norms on a piecework basis, and the payment of bonuses for surpassing these norms, runs throughout the Soviet system.

Control of Unions in the U.S.S.R.

THE SOVIET CONSTITUTION gives workers the right to join labor unions. Probably 90 per cent of the industrial workers belong to a union. But Soviet labor unions are far different from those that exist in the United States. Essentially, they are designed to stimulate production and to administer a complex social insurance system. They do not negotiate in the fields that American unions consider most important—wages and hours.

In July 1958 two important decrees affecting unions were widely hailed in the Soviet press as expanding "industrial democracy" by enlarging the responsibilities of workers committees.

Jay Lovestone, of the AFL-CIO, has questioned their value to the workers.

> Did these decrees signify moves toward industrial democracy? The answer is: No. The much ballyhooed expansion of the committees' right is neither extensive nor decisive. The most important issue confronting any organization which calls itself a trade union is wages. Relative to this issue, the decree provides only for "coordination" between committee and management. In case of any dispute or conflict over wages, management has the last word.
>
> And in regard to most of the other labor problems and needs involving improvement of working conditions, the committees have the right only to propose. In respect to the appointment of the leading personnel, management makes the final decision. The old Communist principle of one-man rule in the enterprise is maintained.[4]

Managerial Incentives

In the preceding pamphlet it was pointed out that the State has given the Soviet manager strong incentives to produce through a bonus system.

David Granick, author of *"The Red Executive: A Study of the Organization Man in Russian Industry,"* succinctly compared the two systems in testimony before a Congressional Committee:

> Managers comprise part of the high-income group of Soviet society just as they do in the United States. A director of a successful Soviet factory with 1,000 workers would earn from five to six times as much as the average worker; the comparable American executive would be in roughly the same position relative to the American factory worker, although the American's absolute standard of living would, of course, be far superior to the Russian's.
>
> In terms of income inequality the relation between worker and manager in Russia and in the United States does not differ too

greatly. Pre-tax, the American manager would be a bit ahead; but, then, his income tax rate is higher. In both countries there is considerable financial incentive for reaching managerial status.

However, the pattern of managerial compensation is radically different in the two countries. In the United States, although there are dramatic exceptions, executives are compensated primarily by means of their salaries. One 1957 study of 50 companies showed that only half of them had executive bonus plans at all, and even in these firms the bonuses averaged barely 10 to 20 per cent of the base salaries. In contrast, Soviet executives depend on bonuses for an average of one-fifth to one-third of their total income.

Such a system places considerably greater pressure on Soviet than on American managers. Moreover, an American executive's bonus is generally awarded on the basis of a whole year's operations, and often has only a loose connection with the specific actions of this executive even over this time period. The Soviet manager's bonus, on the other hand, is paid monthly and is tied directly to the success of the production unit which he is directing; a bare miss of the production target may cut his monthly pay by as much as 30 to 50 per cent.

Not only do methods of compensation place greater pressure for immediate results on the Soviet executive than on the American executive, but a similar effect is achieved by the extraordinary willingness to replace Soviet managers who cannot produce quickly, and to promote those who can deliver the goods . . .[5]

Incentives and Rewards in Soviet Agriculture[6]

MANY OF THE PROBLEMS of Soviet agriculture mentioned in the preceding pamphlet *(Profit Motive or Master Plan)* stem from the desire of the Soviet leaders to develop an all-embracing State control.

Soviet policy toward the peasants has always consisted of a combination of force, indoctrination, and economic incentives —in varying proportions.

About half the people in the Soviet Union—compared to less than one-tenth in the United States—depend upon agriculture for a livelihood. Agriculture is therefore a more important part of the Soviet national economy than in the more industrialized nations of the west—despite the industrial growth of the Soviet Union.

Both the United States and Russia have agricultural "problems." But our problem is overproduction; their problem is underproduction and overprivation.

The effort to achieve production during the Stalin regime was characterized by force. After Stalin, Soviet policy shifted to a greater emphasis on economic incentives and rewards for the farmers.

Under Khrushchev some authority has shifted from Moscow to the republics, provinces, and districts, and some decentralization of the rigid, centralized planning of Stalin's days has taken place. Despite decentralization, however, the grip of state and party rule over collective agriculture has been tightened. Pressure is applied to achieve national goals such as the expansion of corn growing to bolster the lagging feed supply and the campaign to overtake the United States in per capita production of dairy products and meat.

To understand the use of incentives and rewards in Soviet agriculture we should look briefly at the agricultural organization.

Two Types of Farms

TWO TYPES OF FARM ENTERPRISE have emerged in the Soviet Union.

One is the collective farm (*Kolkhoz*) which in theory is a cooperative made up of the pooled holdings of the formerly independent small peasant farmers. In fact, the collectives are under tight State control and their formally elected managers are actually selected and removed at will by Communist authorities.

The second form of farm is the State farm (*Sovkhoz*). State farms are "factory-type" farms owned and managed by the State. They are usually larger than the collectives and specialize in one crop or one kind of animal breeding.

A principal difference in the two kinds of farms lies in the position of the workers. On State farms, workers are paid wages as in Soviet factories. On collective farms, the rank-and-file members, both men and women, work in the fields and in livestock centers under the direction of managers and supervisors just as they do on the State farms. But, as a rule, they are not paid wages. Instead, they divide the income of the collective, after the State secures its share and provision is made for current production expenses and capital outlays.

The payments to collective farmers vary with their skill and the amount of work performed. The greater the skill required, the larger the remuneration.

A cumbersome system of payment has developed, based on so-called "workday units." Plowing for one day, for example, might equal one workday. Milking cows for one day might equal only one-half a workday.

At the end of a year, the value of a workday is determined and each worker is paid (in cash or produce) on the basis of his workdays.

Household Allotment Farming

ANOTHER FEATURE OF THE Soviet agriculture economy is the existence of what is called household allotment farming.

Peasants on collective farms as well as workers on State farms are allotted small plots of land on which they grow potatoes, vegetables, sunflower seeds, and other crops. The peasant households are also permitted to own a small number of livestock and an unlimited number of poultry.

Produce grown on the household farms—above the peasants' own needs—can be sold on the free, so-called *kolkhoz* markets, in the cities.

In other words, two types of markets for food exist in the Soviet Union. One is supplied by the farmers from their household plots. Prices in this market are determined largely by supply and demand. The second form of food market is the State-controlled system in which produce obtained from the State farms or purchased from the collectives at State-set prices is distributed through State outlets.

Visitors report that prices in the free market are somewhat higher than in the State market, but the choice is wider in the free market and the quality is vastly superior.

This "acre and a cow" farming is important not only for the economic welfare of the peasants but also as a source of food for the city dwellers. In 1957, products of this household farming—sold not only through the free market, but through State-controlled outlets—accounted for 19 per cent of meat deliveries, 16 per cent of milk, and 11 per cent of the wool.

The Kremlin frequently voices displeasure with the emphasis given household farming by the peasants and proclaims that, as the collective farming system becomes stronger, the importance of household farming will wither away. Just as in the Marxian doctrine of the eventual withering away of the State, however, no exact time is specified for this development.

Stalin unscrupulously exploited agriculture in his drive toward industrialization—primarily by forcing the peasant to deliver quotas of farm produce to the State at very low prices. If the peasants didn't produce enough, food was taken away—and the peasants left to starve. Some indication of the low prices paid for food is evidenced by the fact that during this era, the volume of sales on the *kolkhoz* markets frequently exceeded the total cash income of the collectives.

To help remedy the difficult agriculture situation and increase production of food and feed, Stalin's heirs have turned to larger economic incentives to stimulate the interest and cooperation of the peasants in the expansion of production. The big stick, in short, is accompanied by a somewhat larger carrot.

One of Khrushchev's first moves was to increase substantially the prices paid by the Government for farm products. In 1953, prices of livestock and poultry products were increased more than five and one-half times; milk and butter, two times; vegetables, on the average from 25 to 40 per cent. Prices of grain and other products were raised later.

As a result of the increased prices and larger quantities acquired, the payments of the Government to collective farms increased substantially. In turn, cash payments to members of

the collectives went up. In fact, cash payments to collective-farm members more than trebled between 1952 and 1956, increasing from 12 billion to 42 billion rubles.

This sum still represents an average cash income of only about $200 per year per family on the collective farms. Moreover, in evaluating this figure it must be remembered that the small household allotments are still not playing their theoretically assigned minor role but often outstripping the collective economy as a source of the peasants' income.

Even with increased incentives, the agricultural problem of the Soviet Union has not been solved. Agricultural production has increased markedly in recent years—due both to increased productivity and to a policy of putting vast new areas into cultivation. In the three years between 1954-56, 90 million acres (almost equal to the combined arable land of France, Western Germany and the United Kingdom) were put to the plow. Even with low average yields, the addition of acreage on such a scale is likely to increase production—although one may be skeptical whether it is low-cost production as the Soviets claim.

Charles B. Shuman, President of the American Farm Bureau Federation, pointed out to a Congressional Committee:

> From a long-run standpoint, our greatest advantage over the Soviets in agriculture, as well as in other fields, is not to be found in natural resources or technology, but in the fact that we have an incentive system, while the Soviets have a planned economy.
>
> The Soviets have recognized the need for individual incentives to a degree, but collective farmers and employees of State farms cannot possibly have either the opportunity to exercise individual initiative or the incentive to improve efficiency that the individual farm operator has under our system . . .
>
> Despite the limitations inherent in a planned economy, the Soviets have a great potential for increasing the productivity of their agricultural workers. If we are to maintain the margin of advantage which the United States now has over the U.S.S.R. by reason of the greater productivity of our agricultural workers we must avoid hamstringing the further growth and development of American agriculture.

> This means that we must avoid policies that substitute Government planning for the operation of an incentive system and policies that attempt to freeze farming in a rigid historical mold, or otherwise prevent needed adjustments in the resources (including human resources) devoted to agriculture . . .
>
> Although a market system does not always work as smoothly and as painlessly as we might wish, it is still the most efficient system for determining what things are really worth and how scarce resources can be used . . .
>
> Centralized planning can produce spectacular results in individual undertakings, but it cannot mobilize the total energies and abilities of individual citizens as effectively as an incentive system. In a market system, the mistakes of individuals tend to cancel out with little effect on over-all progress of the economy, but when the planners make a mistake in a planned economy, the result may be nationwide and disastrous.[7]

How Rewards of Production are Distributed in the United States

The forces governing the relative shares of the total production of goods and services going to each group which contributes to production are both controversial and complicated.

And yet, in view of the relentless attack on our system by the Communists, it is important to gain some idea of the way "the laws of distribution" operate in the market—and why? How do economists explain wages, and interest, and rent and profits? How does the market evaluate each of the factors of production?

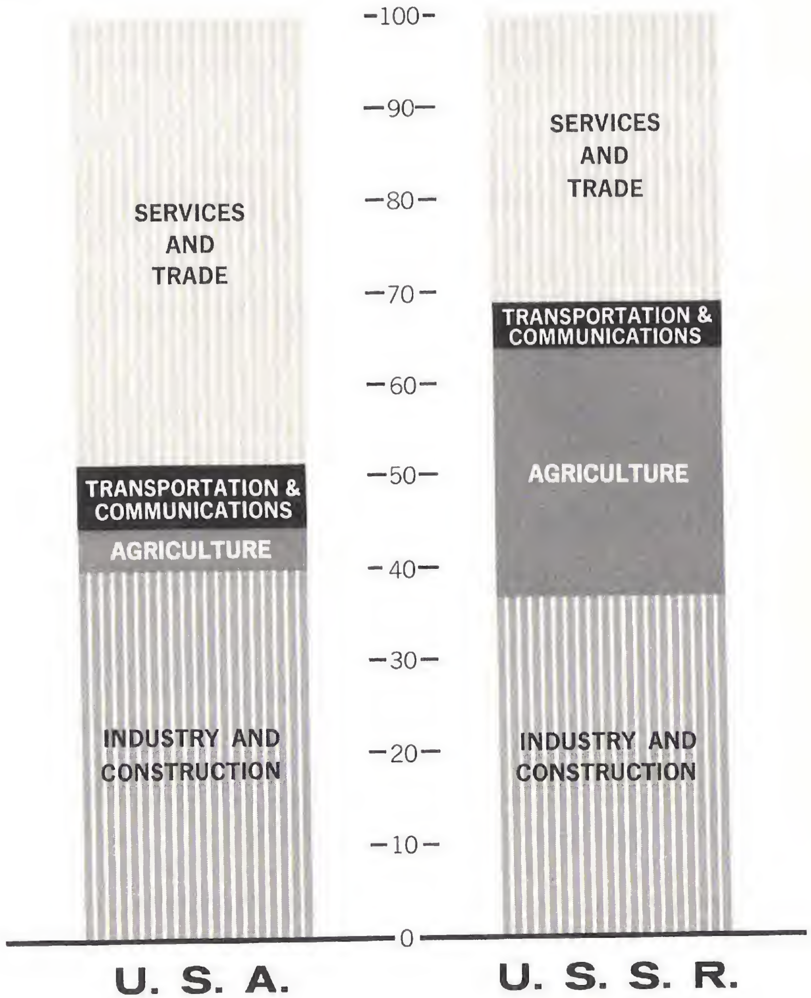
No one argues that the market perfectly distributes rewards on the basis of merit. Everyone knows of cases in which people have become rich—without apparently contributing much to the nation; and other cases in which people have worked hard all their lives and yet seemed to be dogged by "hard luck."

And yet, over-all, we have achieved a scale of living which has made us the envy of all the rest of the world.

FIGURE 1

Industrial Sources of National Income in the U.S.A. and the U.S.S.R., 1955

(In Percent)



SOURCE: U. S. Congress, Joint Economic Committee. Comparisons of the United States and Soviet Economies. (1959)

How the national income is distributed among the population is a matter of great importance, affecting the growth and stability of the nation, and freedom and welfare of the individual. We may look at the division of income among producers or among family income groups. Among either producers or family groups, of course, patterns of income distribution vary from time to time.

Compensation of Employees

It is not surprising that the compensation of employees (wages, salaries, etc.) is by far the largest item in national income. Over 70 per cent of the national income goes to wage and salary earners.

In the final analysis the value placed by the market on the product of labor gives labor its value.

If you caught fish with your bare hands or picked berries in the wilds, your day's wages would be exactly equal to what you could sell your catch or your berries for. A shoe shine boy working on the corner makes exactly what he receives for the shines—less the cost of his materials.

Such simple wage determination is rare today, of course. Most of us work with tools and instruments of production owned by others. But, even in such cases, the value of labor is related to the value of the final product. The sales dollar must be divided among those who provide the labor, the tools, the natural resources, supplies, utilities, the management, etc., that are all combined in the final product.

In making this division, it is the law of supply and demand that basically determines wages, just as it determines the price of the things you buy.

One point is so obvious that it is frequently overlooked. We speak of the supply of labor; there are many different types and qualities of labor supply.

You as a consumer may debate whether to spend your hard-earned dollars on one make of television or another, and you

may even debate whether to spend your dollars on a television or on a home movie camera.

But an employer who wanted a butcher would not debate with himself whether to hire a butcher or a crane operator. He is concerned only with the supply of butchers.

Even though it may appear that high—or low—wages for various jobs are caused by different reasons than supply and demand, closer inspection will likely show there is some connection.

For example, men who build skyscrapers or paint high towers may appear to be receiving high pay because the work is dangerous. However, the mere fact that it is dangerous may mean that there are fewer applicants than there would be for safer jobs—and there would be still fewer applicants if the pay were low.

Sometimes, it might appear that high wages result from years of training—and yet there is still a connection between supply and demand. Few people, for example, can spend the years of training required to be a doctor and so the supply is low in comparison with demand.

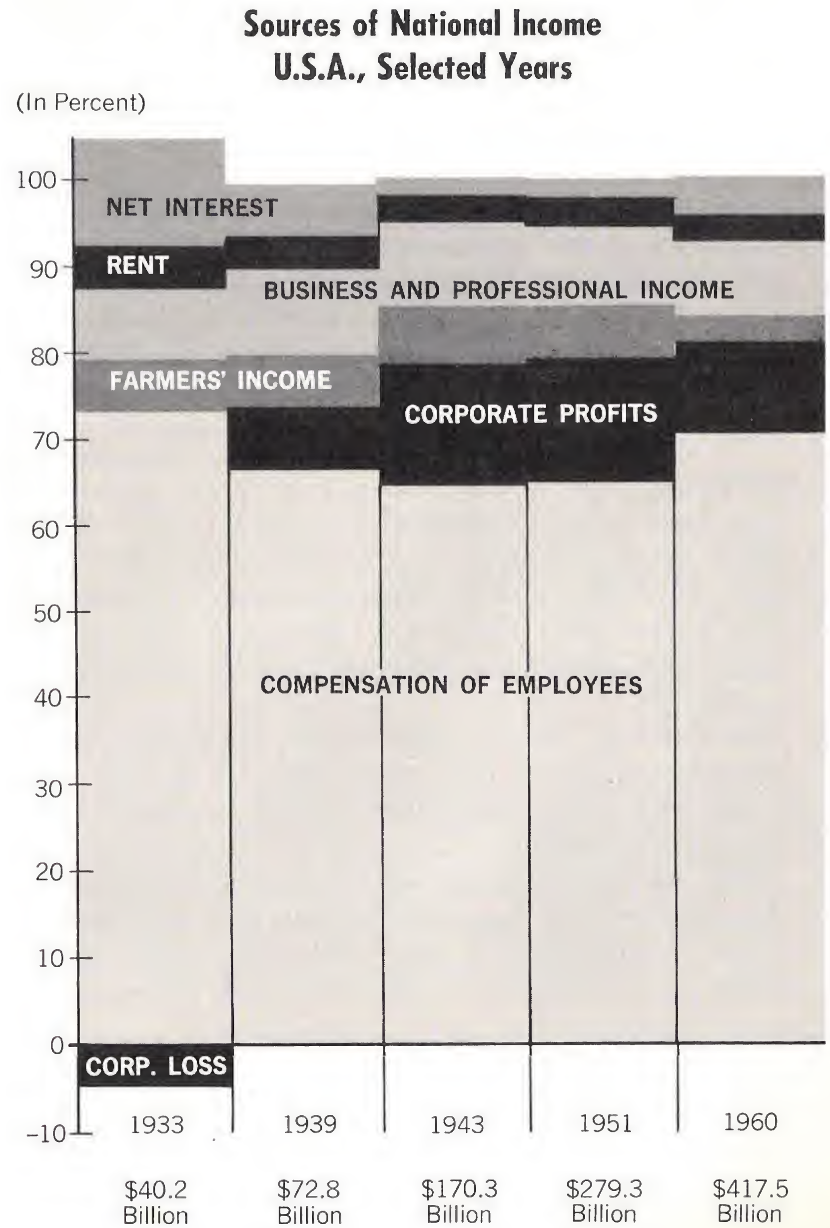
A decade or so ago, an electronic engineer might have found it difficult to get a job at all. Even if he were successful, it would have been at a much lower salary than he would receive today—for a job requiring the same training. Although there are many more electronic engineers than there were a few years ago, the demand has skyrocketed.

From the standpoint of our economy as a whole, one of the most important advantages of the law of supply and demand as it acts to set wages is that it tends to channel workers into fields where they are needed most.

In short, if the people decide through their dollar votes that they want to buy automobiles rather than buggies, the expansion of the automobile industry will require more workers—and higher wages may be paid to attract them than need be (or can be) paid by the declining buggy industry.

At the same time, of course, it must be remembered that the complex law of supply and demand is modified by many things.

FIGURE 2



SOURCE: U. S. Department of Commerce

For example, collective bargaining may—or may not—set the same wages in a particular area that would be set by the market. Although some people contend that collective bargaining cannot materially affect the proportion of the national income going to labor as a whole—that is to both organized and unorganized labor, skilled and unskilled labor—it can undoubtedly affect the share going to individuals in certain groups of workers.

Wages are also affected by laws of various kinds, such as the Federal Fair Labor Standards Act which was first passed in 1938 and has since been amended several times. This law sets a floor under wage rates, and because the legal wage is determined largely by political pressures rather than by market forces it may result in a quite different wage level than would normally result.

Interest

MOST OF US THINK of interest as a cost that we pay when we borrow money to buy a car or assume a mortgage to buy a house. But when we pay it, interest becomes income to someone else. Interest earnings—not including interest payments on the national debt—was some 4.5% of the national income in 1960.

Reasons why labor is entitled to a reward for its work are clearly evident to most of us; reasons why other factors in the productive process must receive a reward are not always so obvious.

Why, for example, should we pay interest to someone who has money and isn't using it? Karl Marx said that "interest is a form of exploitation of labor" and Soviet economists have fought against using it. Yet they have been forced to use it as a calculating tool.

We commonly think of interest as payment for money borrowed. Obviously, few of us would borrow money and then put the money in a sock under the bed. We borrow the money to buy a car, a refrigerator, or a house. Then, we use the car, or the refrigerator, or a house while we are paying back the money and the interest on it.

In short, we are paying interest to *use immediately* something we will pay for later.

Suppose you saved $150 to buy an outboard motor for your boat. On the way to the store, an acquaintance stops you. "Lend me your $150," he says. "I want to buy an outboard motor for my boat. I'll repay the $150 in three months."

Would you lend the $150 so that he could buy a motor immediately, while you waited three months?

Suppose, however, that he offered to return you $160 within two months—or $170 within three months? Some offer might tempt you to postpone your purchase of the motor and lend him the money.

Thus, one explanation of interest is called the "abstinence theory" by the economists. It means that you abstained from buying your motor when you wanted it, and were entitled to some reward for your self-denial.

Or, interest can be looked at from the standpoint of the borrower. You may have heard a manufacturer say, "I borrow money to make money." He means, of course, that he is perfectly willing to borrow $250,000 and pay $1500 interest on it to buy a new machine that will increase his production and his earnings enough to cover both the cost of the machine and the interest on it over a period of years. The economists call this the "productivity theory of interest."

Basically, interest is a price, and like other prices in a market economy it is determined by the law of supply and demand. If the demand for funds by borrowers is less than the supply of funds available from lenders, the price of borrowing money—interest—will go down. If the demand from borrowers is greater than the supply of funds available from lenders the price will go up.

In practice, of course, the operation of the market is continually affected by Government monetary policies. At first glance, it might appear, that the solution to high interest rates is to make money more plentiful. But, for reasons discussed in Pamphlet 6 *(The Big Picture)* and Pamphlet 7 *(Meeting the Economic Challenge)* making money "cheap" can create more problems in the form of inflation than it solves.

How Interest Aids Economic Growth

PAMPHLET 3 *(Profit Motive or Master Plan)* emphasized that the steady improvement in our scale of living depends on steadily increasing productivity.

It also pointed out that the productive ability of labor can be increased by giving those who work more and better tools and machines.

For an economy to grow it must continually produce more than it consumes. Some of what is produced must be put back into the economy in the form of new and better equipment and plants.

A tremendous investment in new tools and equipment is needed to improve old jobs and to establish over a million new jobs each year for workers.

The average American worker in manufacturing industry works with about $15,000 of capital in the form of tools, machinery, etc. In the electric utilities field, investment in capital per worker is about $60,000; in the railroad field, it is over $20,000; in the chemical field, it is nearly $40,000.

The need for investment funds is met through savings. Some people in the United States must not consume their full share of production, but must save part of it if adequate savings are to be available.

Fortunately, in the United States money saved by individuals is channeled into productive use in many ways. For instance, savings banks and insurance companies accumulate the savings of some people and lend them to others for productive purposes. Thus, even though many individual savers do not directly put their savings into plants and equipment, their savings are still used by others who put them to work.

The Soviet Government has waged a consistent propaganda campaign to induce the people to save more, and individual savings in the banking system are rising. Some of these savings undoubtedly go into state investment, but there are many indications that the campaign is designed more to combat inflation than to raise money for investment purposes.

As long as the State controls the total economic process, it can make sure that the people consume less than they produce.

Until a few years ago, the Soviet citizens were required to buy Government bonds in amounts roughly equivalent to four weeks' wages. In 1947, the Government issued one new ruble for 10 old rubles, and at the same time repudiated most of the Government's debt and wiped out most of the people's savings. Again, in 1957, when the compulsory system of bond purchases was eliminated, the Government ordered a 20-year suspension of redemption payments on Government bonds.

On a broader scale, it is interesting to note that Marx's refusal to consider interest on capital as a cost has led to a great misallocation of resources in the Soviet Union. For example, Soviet planners pushed the construction of hydroelectric generating stations because they seemed to produce the cheapest electricity. However, no consideration was given to the fact that capital investment was tied up in construction for a long time. It was this failure to consider the cost of interest on investment that Khrushchev was assessing when, in 1958, he called for increasing emphasis on thermal power plants which can be constructed more quickly and thus provide a return on investment more quickly.

Rent

IN 1960, ABOUT THREE PER CENT of our national income was rent.

We all know that we have to pay "rent" for use of an apartment or house as well as for the land on which it stands. The amount we have to pay depends on many things, location, age, size, and the well-known law of supply and demand.

Edmund Nash, in his article on the "Purchasing Power of Workers in the U.S.S.R." says:

> The Soviet press frequently boasts that, unlike workers in the United States, Soviet workers have the benefit of low rentals and free medical services. Soviet medical care, however, is free only in the sense that the Soviet population does not pay for it directly on a fee-for-service basis; it is paid for by part of the funds obtained through taxation in the form of increased prices

in consumer goods. This taxation constitutes roughly one-half the price of all consumer goods . . .

The English-Language newspaper *Moscow News* on September 16, 1958, reported that, under a 1926 decree still in force, Soviet workers expended only 4 to 6 per cent of their monthly earnings for rent, the amount depending on the income of the tenant, the building in which he lived, and other factors.

However, it was not mentioned that in Moscow, most families lived in only one room and had to share bathrooms and kitchens with other families, and that every family had to pay extra for such utilities as light and heat.[8]

Profits

PROFITS IN OUR ECONOMY vary from year to year. They are what is left over after other productive agents have been rewarded. But it is not by accident that the followers of Marx have unleashed their heaviest guns against profits. They know—perhaps better than many Americans—that if they wish to destroy the market system one of the best ways to do so is continually to depict profits as evil and as benefiting only a few.

In the last session, we saw that the search for profits was a powerful stimulant for directing our limited resources into the most useful purposes as signalled by free buyers, and for promoting efficiency in production. We saw that when a business fails, the consumer is saying, in effect, you have misused scarce resources.

But, in addition to promoting cost-cutting and improved productive techniques, profits provide two other major incentives in our economy: (1) They spark extra effort to assemble and organize resources into a producing firm or factory; (2) They stimulate organization of new risky businesses and the search for new products.

1. Sparking extra effort to assemble and organize resources into a producing firm.

The majority of us are on someone else's payroll. The motives to work and to save are common to us all. But it is profit expectation—the hope of reward over and above what could be earned by working for others or lending out our savings at

interest—that is the prime mover in getting new businesses started in the United States.

A carpenter goes into the construction business—with the hope of not only earning wages but of earning a profit. If he can build a house that consumers will buy when they compare it with other houses, he will be successful—and earn a profit. A truck driver may launch a trucking business or open a garage—with the hope of making a profit.

An expanding economy needs payrolls—and needs payroll-makers.

2. Stimulating New Risky Businesses.

When a firm brings out a new successful product, profits may be high for a time. But other companies lured by the high profits also go into the business. Profits decline for both the originator and the newcomer. The search for profits, therefore, relentlessly spurs the search for new, better and unique products and services.

It has been reported that:

Nearly one-third of the employees of the General Electric Company are working on products not manufactured by the company in 1939. The Corning Glass Company received three-fourths of its income in 1955 from products it had developed since 1940. The DuPont Company estimated that half of its current sales are in products developed during the past 20 years; and the General Foods Corporation has reported that 16 per cent of its sales in 1953 were of products developed since World War II. For business as a whole perhaps as much as a fifth of current sales are being made in products which are essentially postwar creations.[9]

As the search for profits leads to new jobs, new services, new products—it helps give all of us a better standard of living.

Our 10 million separate enterprises and self-employed individuals (including agriculture) produce some 8-10 million different items and hundreds of thousands of different services.

New products and better services will continually unfold in the future under the spur of the profit motive.

David McCord Wright, a prominent economist, has raised an interesting point in this connection:

. . . if a particular industry shows unusual profits, many people will come into the field and by increasing output bring down the price and eliminate unusual profit returns. Nobody disputes this analysis in so far as there is any real degree of competition and freedom of access to the particular field.

The trouble, however, with a good deal of modern literature on the subject is that it overlooks one vital step in the process. The increase in supply which results from the entry into the industry of a large number of new units, is not induced by *low* profits. Quite the contrary. It is *high* profit that induces the very increase in the industry which eventually gives low profit.

In other words the sequence of events over time would be as follows: High prices would induce increased investment, which in turn would reduce profits to normal.

But the question almost never asked is this: What would happen if . . . we eliminated the *high* profit before we got the additional investment?

In that case, it is probable that an increase in output never would spontaneously occur.[10]

Government Redistributes Income in the United States

As we will see in Pamphlet 5 *(The Role of Government)* market distribution of income in our economy is modified considerably by governmental taxing and spending programs, collective bargaining, legislation, and other means.

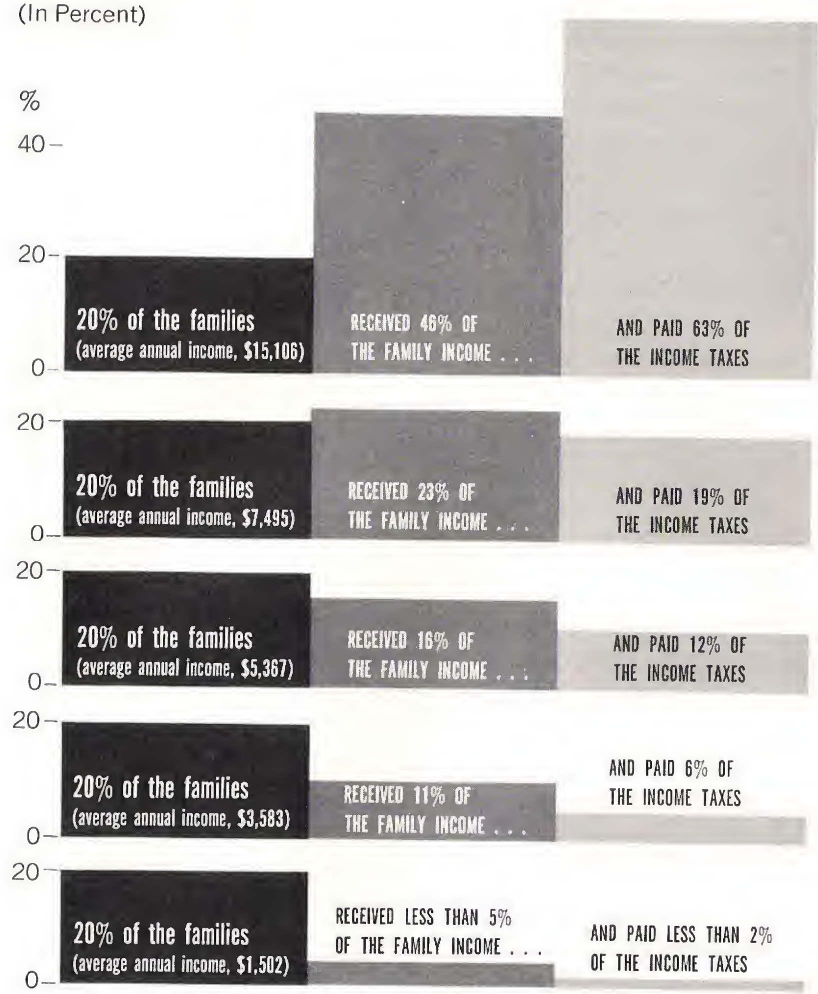
The Government—federal, state and local—collects almost one-third of the national income in taxes. It then redistributes these funds in various ways.

Many governmental spending programs substantially raise the income position of families in the lower income groups. In 1957, for example, what are called government transfer payments transferring income from one group to another accounted for almost a quarter of the income of families whose income was less than $4,000.

FIGURE 3

How Total Family Income and Federal Income Taxes Were Distributed Among Family Income Groups, U.S.A., 1959

(In Percent)



SOURCE: U. S. Department of Commerce, Survey of Current Business, May 1961

Few people would dispute the importance of redistributing some income to prevent economic hardship—especially for those who have no productive services to offer in the market.

At the same time, few would question either the possible dangers of ever-increasing income redistribution through political processes and political pressures. Placing ever-heavier tax burdens on efficient producers to subsidize less-efficient producers or non-producers can interfere with incentives.

The competitive actions of free individuals and free enterprise still generate the bulk of our national output and income.

Free consumers ultimately decide what's produced.

Free enterprise determines how to organize labor and capital to produce at the lowest cost for competitive markets—including world markets.

The fact that no one knows exactly at what point reduced incentives lessen our ability to compete competitively does not alter the warning voiced by Dr. G. Warren Nutter, an authority on Soviet growth:

> The driving force within the American economy has been private initiative mobilized by the incentives inherent in a free society.
>
> The trend of the day is in choking off incentives . . . Incentives are being strangled and nothing is being put in their place.[11]

In selecting the incentives that make an economy operate successfully there is a choice: The carrot or the stick?

Communists have proved they do not hesitate to use the stick. But they are increasingly, although grudgingly, recognizing the importance of the carrot.

We as a free people will not use the stick. We must continue to rely on strong incentives to promote individual vision, drive and initiative. Redistribution of wealth and income carried to the point that it impairs this vision, lessens drive, or curbs initiative can hurt an economy.

Individual effort enriches all of us—we benefit from the rise in productivity of our neighbors and citizens generally. Under competition, cost-reductions and productivity improvements are widely shared without any edict from a commissar or government.

As a result, students of human well-being are increasingly concluding that effective efforts to "bake a bigger pie" are far more rewarding in terms of rising per capita income than any conceivable compulsory plan for sharing the wealth we now have or the income we now receive.

NOTES

1. *AFL-CIO Free Trade Union News.* July 1959. Quoted in "Basic Distinctions Between the Soviet and American Economies," *Comparisons of United States and Soviet Economies.* Joint Economic Committee, Congress of the United States. 1959. p. 565.
2. "Purchasing Power of Soviet Workers." Edmund Nash. *Monthly Labor Review.* United States Department of Labor. April 1960. p. 363.
3. *Through Soviet Windows.* Joseph E. Evans. Dow Jones & Company, Inc. New York. 1957. p. 13.
4. "Basic Distinctions Between the Soviet Economy and American Economy." Jay Lovestone, AFL-CIO. *Comparison of United States and Soviet Economies.* Joint Economic Committee, Congress of the United States. 1959. p. 563.
5. Soviet-American Management Comparison." David Granick. *Comparisons of the United States and Soviet Economies.* Joint Economic Committee, Congress of the United States. 1959. pp. 144-145.
6. This discussion of Soviet agriculture draws heavily on "Agricultural Policy of the Soviet Union." Lazar Volin. *Comparisons of the United States and Soviet Economies.* Joint Economic Committee, Congress of the United States. 1959. pp. 285-318.
7. "An Agricultural View of the Soviet Threat." Charles B. Shuman. *Comparisons of the United States and Soviet Economies.* Joint Economic Committee, Congress of the United States. 1959. pp. 499-500.
8. "Purchasing Power of Soviet Workers." Edmund Nash. *Monthly Labor Review.* United States Department of Labor. April 1960. pp. 363.
9. *Saturday Review.* January 19, 1957. p. 25.
10. *Capitalism.* David McCord Wright. McGraw-Hill Book Co. New York. 1951. pp. 165-166.
11. "The Structure and Growth of Soviet Industry." G. Warren Nutter. *Comparisons of United States and Soviet Economies.* Joint Economic Committee, Congress of the United States. 1959. p. 120.

Suggested Reading

EVANS, JOSEPH E., *Through Soviet Windows,* Dow Jones & Co., New York. 1957, $1.00. Readable discussion by a reporter for the *Wall Street Journal* about the Russian economy with special emphasis on how the Russian people live and work.

INKELES, ALEX and BAUER, RAYMOND A., *The Soviet Citizen: Daily Life in a Totalitarian Society,* Harvard University Press, Cambridge. 1959, $10.00.

LEVINE, IRVING R., *Main Street, U. S. S. R.,* Doubleday, Toronto. 1959, $4.50. Account of life in Russia.

SCHWARTZ, HARRY, *Russia's Soviet Economy,* Prentice-Hall. 1954, $9.00. A comprehensive and well-documented work by a *New York Times* expert.

United States Chamber of Commerce, *Prices, Profits and Wages,* Washington, D. C. 1960, $.50. Examines the interrelations of prices, profits and wages.

United States Chamber of Commerce, *Understanding the Economic System and Its Functions,* Washington, D. C. 1961, $.50. Discusses the basic functions that any economic system must perform.

United States Congress, Joint Economic Committee, *Comparisons of the United States and Soviet Economies,* U. S. Government Printing Office. 1959, $1.90. Papers submitted by experts on the Russian economy to the Subcommittee on Economic Statistics before which they appeared as panelists.

PROGRESS THROUGH VOLUNTARY
ACTION AND FREEDOM

380-064